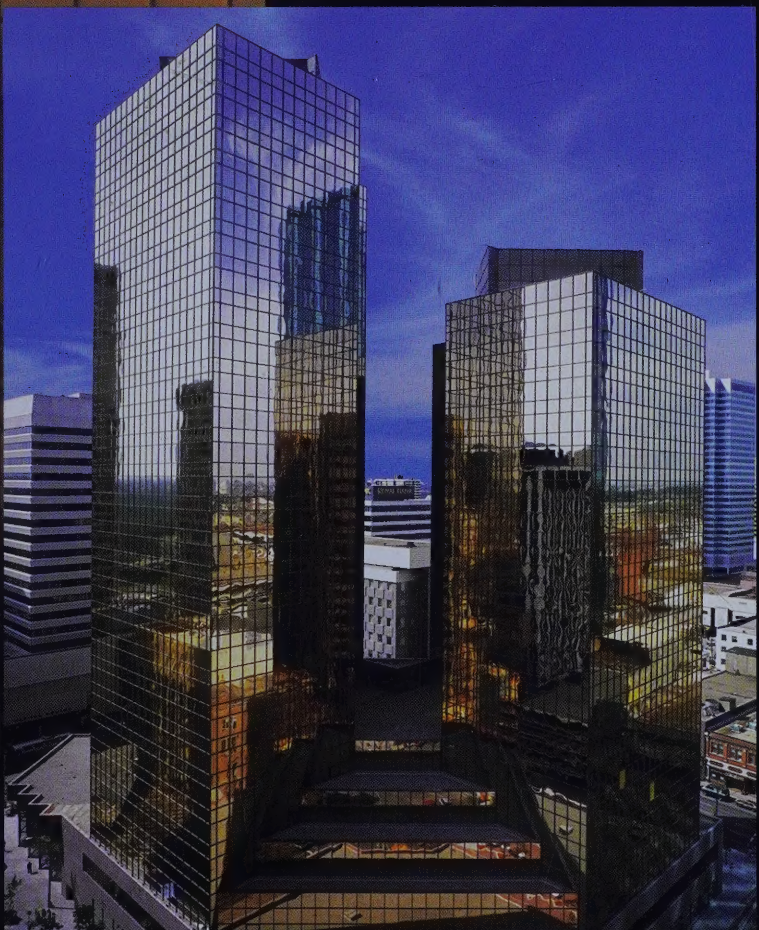
Morguard

Real Estate Investment Trust

1998 Annual Report



Morguard
Real Estate Investment Trust

Corporate Profile

Morguard Real Estate Investment Trust

is a closed-end investment trust, owning a highly regarded portfolio of income producing properties. The Trust has two objectives:

- **To provide unitholders with stable and growing cash distribution on a quarterly basis; and,**
- **To maximize unit value through the acquisition and prudent development of additional properties and through active management of the portfolio.**

The Trust's portfolio is managed by Morguard Investments Limited, one of Canada's most experienced and committed real estate organizations.

Morguard's management of the REIT provides continuity, market credibility, an extensive national presence and the expertise of a tested and proven real estate management team.

Cover Photography

Scotia Place
Edmonton, Alberta

Content

1998 Highlights

- Distributed 72 cents per unit to unitholders, exceeding the Trust's first-year target of 70 cents per unit
- Acquired seven properties worth $84 million (plus future commitments of $45 million), adding more than 1.5 million square feet of leasable space to the portfolio:
  - Aurora, Ontario (retail)
  - Market Square, Kanata, Ontario (retail)
  - Centrepoint Plaza, Belleville, Ontario (retail)
  - Montréal, Québec (industrial)
  - Burnaby, British Columbia (industrial)
  - Times Square, Ottawa, Ontario (office and retail)
  - Cambridge, Ontario (industrial)
- Completed the disposition of two properties for combined proceeds of $14.1 million and a combined gain on sale of $1.9 million:
  - Burnaby, British Columbia (industrial)
  - Victoria, British Columbia (retail)
- Increased the weightings of eastern Canada and retail properties in the portfolio to 45.9 percent and 33.7 percent, respectively
- Successfully completed an offering of $55 million in senior unsecured debentures
- Collected the final instalment on the Trust's units for aggregate proceeds of $100 million

Morguard REIT Opportunity

Morguard Real Estate Investment Trust (REIT) was created following an initial public offering in 1997. The proceeds were used to purchase a portfolio of well diversified income producing properties located across Canada – including shopping centres and office and industrial buildings. Morguard REIT's asset base has grown through the acquisition of properties which have provided cash flow growth and asset appreciation potential.

This highly regarded portfolio of income producing properties was originally developed and managed by Morguard Investments Limited. Morguard is one of Canada's most experienced and committed real estate organizations, with a track record of providing excellent returns to investors for more than 20 years. Morguard's management of the REIT provides continuity, market credibility and the expertise of a tested and proven real estate management team.

Through its prudent and financially conservative investment policy and geographic and product diversification, Morguard REIT offers investors a unique opportunity to participate in a diverse portfolio of Canadian real estate assets. Morguard REIT is committed to providing stable and growing cash flow and appreciation in unit values.

Morguard REIT has exceeded the investment goals established in its initial public offering. The combination of high quality income producing assets, experienced management and a conservative financial position provide investors with a strong vehicle for both income and value growth.

Report to Unitholders

Antony K. Stephens
President and
Chief Executive Officer

1998 was a very successful year for Morguard Real Estate Investment Trust. When we began our life as a publicly traded entity in October 1997 we set out a number of specific goals to be achieved by the end of our first full fiscal year of operation. I am very pleased to report that we achieved these targets.

First and foremost, we set a target to grow the Trust's portfolio to a book value of $450 million. By December 1998 we had completed a total of nine acquisitions, including seven in the last year. Through our prudent, active management of the Trust's assets, we expanded the size of the portfolio to 67 properties totaling approximately 5.9 million square feet of leasable space. Most importantly, we have grown the book value of the portfolio to $440 million, plus an additional $45 million in future commitments.

Place Désormeaux
Longueuil, Québec

We also sought to increase the proportion of our properties in both eastern Canada and the retail segment of the portfolio. Currently, 45.9 percent of the Trust's properties are located in eastern Canada, up from 34.0 percent at the time of the IPO. Similarly, retail properties now comprise 33.7 percent of the portfolio, up from 30.0 percent when the Trust began.

Finally, it was our intention to provide unitholders with a distribution of 70 cents per unit in 1998, based on a payout of 90 percent of distributable income. Through improved rents, higher occupancies and

accretive acquisitions, we exceeded our target, paying out distributions of 72 cents per unit. Moreover, we expect this growth to continue this year.

The Trust's ability to achieve growth in distributions reflects its strict acquisition criteria. We select only properties that are accretive to cash flow, that benefit from positive leverage, and that enhance the long-term value and diversification of the portfolio.

In April, we successfully completed our first financing since the IPO, a $55 million unsecured senior debenture offering. The proceeds allowed us to take advantage of several acquisition opportunities that contributed to the growth momentum of distributions.

With a successful first year behind us, we are now firmly focused on the future.

With a successful first year behind us, we are now firmly focused on the future. Our primary objective continues to be the provision of dependable and growing distributions to our unitholders and maximizing the value of the Trust's units.

As a REIT that is diversified both in terms of property type and geographic location, we are able to leverage our expertise in several asset categories and regional markets. This flexibility allows us to create our own opportunities, capitalizing on current market trends and their underlying economic factors. Furthermore, with added diversification through our broad mix of tenants, our unitholders are shielded from undue risk associated with a particular company, market, or industry.

5th & 3rd Building
Calgary, Alberta

We have an office in every market in which we are active. Our people work in specialized teams dedicated to office, retail or industrial properties. This market expertise allows us to identify and react quickly to market opportunities that benefit the Trust and its unitholders. For example, in September, we sold a well located warehouse property in Burnaby, British Columbia for a price of $7.35 million. The property had been acquired three months earlier for $6.2 million, resulting in a gain of $1.15 million.

Report to Unitholders

At the same time, our diversification strategy reduces the risk associated with the potential downturn in a particular segment of the real estate market. With properties spread across the office, retail and industrial sectors, we are well positioned to maximize returns to unitholders.

We are well positioned to maximize returns to unitholders.

1998 was a less than spectacular year for capital markets in Canada, and the real estate sector was no exception. The real estate sub-index of the Toronto Stock Exchange managed a total return of negative 12.71 percent for the year, while the TSE 300, the benchmark performance measure for the Toronto Stock Exchange, returned negative 1.96 percent. Similarly, the CIBC Wood Gundy REIT index returned negative 10.8 percent. Despite excellent fundamentals in the real estate market, real estate investment trusts, and real estate issues in general, suffered from what appeared to be an oversupply of real estate equity in the marketplace, the result of the proliferation of new real estate issues in 1997.

Scientific Atlanta
Burnaby, British Columbia

Yet, the Canadian real estate industry continues to prosper, buoyed by strong economic fundamentals. And the outlook is just as positive. Going forward, we expect historically low interest rates, strong consumer confidence and sustainable economic growth to contribute to a robust real estate industry in Canada.

In the office sector, vacancy rates continue to decline while rental rates increase. Office buildings are trading below replacement cost and development remains almost non-existent, with Calgary being the exception. The outlook for the future of the Trust's office properties remains strong, as the economy continues to support high occupancies, lease turnovers and balanced supply and demand.

Likewise, our retail properties are well positioned to benefit from continued consumer confidence and economic growth. Historically low interest rates and stable employment are driving consumer spending. This environment should factor positively on the retail segment of the portfolio.

Alberta Treasury Branch
Calgary, Alberta

The demand for industrial space remains healthy, as a favourable lending environment fosters business expansion. We anticipate increasing cash flow from the industrial portion of our portfolio as businesses continue to make capital investments towards their future growth.

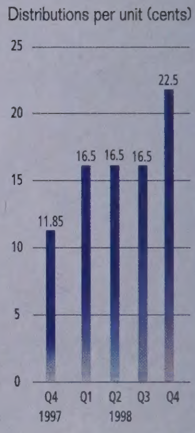
I would like to take this opportunity to express my gratitude to all those employees of Morguard Investments, the Trust's advisor, and to the officers and trustees of the Trust itself, whose hard work and dedication have made the Trust's first year a success.

The stage is set for continued growth at Morguard Real Estate Investment Trust. Through its diversified portfolio of high quality properties, specialized teams of personnel dedicated to office, retail and industrial properties, and its focused acquisition and development programs, Morguard REIT is well positioned to capitalize on opportunities to build significant value for its unitholders.

The stage is set for continued growth at Morguard Real Estate Investment Trust.

Antony K. Stephens
President and Chief Executive Officer

Focus on Performance



1998 was an excellent year for the Canadian real estate market. Year-over-year asset values increased significantly, and were further enhanced by improved cash flow as rents renewed at higher rates, due to increased demand for space and greatly reduced availability.

Two factors continue to significantly affect real estate investment. First, property values remain below replacement cost for office properties, meaning that rents will continue to rise before any large-scale development takes place. As a consequence, there is plenty of scope for real estate portfolios to prosper in the current cycle through acquisition and increases in cash flow and values of existing properties. Second, low interest rates, a corollary of low inflation, present an opportunity to create profits through leverage.

Balanced Portfolio Maximizes Returns

Morguard's investment strategy for maximizing returns to investors has consistently focused on having a well balanced portfolio by both product type and geographic diversification. Such diversification provides unitholders with the additional security of knowing that their investment is not dependent on a single market or product type. This investment strategy complements the other Morguard REIT investment criteria. The first is to provide unitholders with stable and growing cash distributions on a quarterly basis. This tax-deferred cash flow comes from our portfolio of high quality, income producing properties under long-term leases by creditworthy tenants. The second is to maximize unit value by both active management of the existing portfolio, including redevelopment of properties, and acquisition and prudent development of additional properties.

National Team with Local Expertise

Morguard's comprehensive infrastructure enables us to act quickly and intelligently to capitalize on market opportunities for the benefit of unitholders. Each real estate asset is a 'local' business, and our strong presence in the markets we invest in is designed to maximize value for every property.

Team Excellence A very experienced team of real estate managers continually assesses the performance of the portfolio commensurate with a pre-determined level of risk. Their prudent decisions, based on sophisticated asset management analysis, are designed to optimize returns to unitholders.

Strong Infrastructure As a national organization, Morguard has the resources to apply a hands-on approach to asset and property management. This ensures consistency, quality control and the ability to make complex decisions quickly. A reflection of this are the 15 Building Owner and Managers Association (BOMA) "Building of the Year" Awards which have been awarded to Morguard over the years.

Market Intelligence Sound market intelligence is the basis for astute real estate decisions. Morguard's extensive network ensures that we have superior access to local market knowledge, plus a comprehensive perspective of the national real estate investment climate.

Tenant Satisfaction Satisfied tenants renewing leases at market rates is a critical objective of Morguard. We have one of the highest rates of tenant retention in the business. Our property management team has a mandate to deliver the best possible proactive service to tenants to ensure a high level of satisfaction with their choice of business premises.

Our leasing programs include building strong relations with members of the brokerage community, comprehensive promotional programs and the ability to make quick decisions and commitments on lease documentation.

Sophisticated Operations Benefit Investors

Our state-of-the-art MIS systems are designed to provide unitholders with timely and meaningful reporting on the status of their investments. We utilize the most advanced technology to ensure investor expectations are met. Morguard has been addressing issues raised by the Year 2000 and is implementing solutions to ensure a smooth transition.

Morguard has been a pioneer in the development of performance measurement for real estate in Canada and our advanced analytical models allow us to forecast risk and return scenarios in multiple markets and product categories. These sophisticated analytical tools contribute to Morguard's ability to provide investors with sound asset management.

Outlook Continues to be Positive

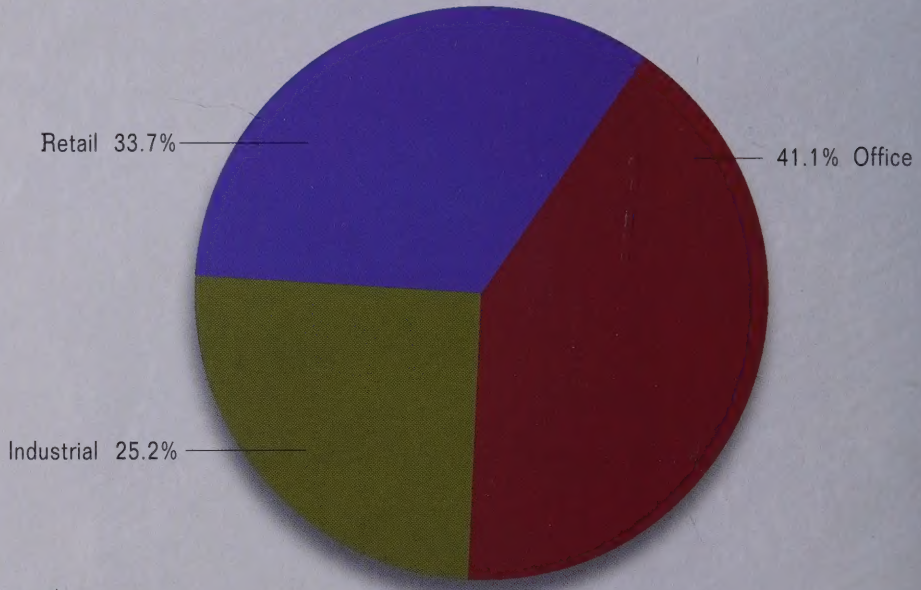
The real estate market in Canada continues to be active and we have an optimistic outlook. Our infrastructure will enable us to identify new acquisition opportunities and to create additional value through development and redevelopment within the existing portfolio. Our goal is to maximize cash flow and long-term asset values and we are confident that these objectives will be met.

Portfolio Diversification

(Book cost)

(000s)	
Office	$ 179,325
Retail	147,311
Industrial	110,091
Total	$ 436,727

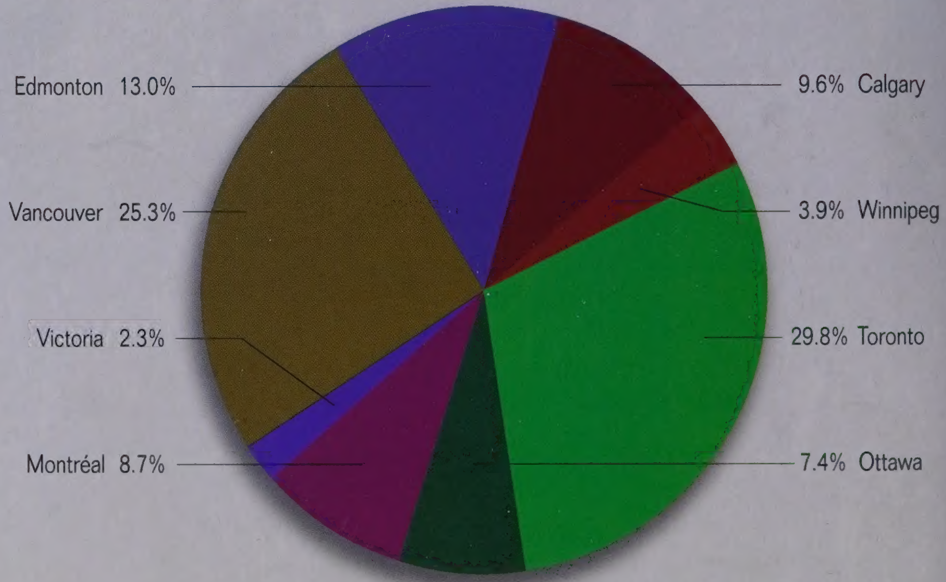
Diversification by Property Type



As of December 31, 1998

(000s)	
Victoria	$ 9,941
Vancouver	110,575
Edmonton	56,880
Calgary	41,813
Winnipeg	17,357
Toronto, Cambridge, Barrie & Aurora	130,129
Ottawa & Belleville	32,151
Montréal	37,881
Total	$ 436,727

Diversification by Property Location



As of December 31, 1998

Scotia Place
Edmonton, Alberta

Geographic Diversification

- ● Office Properties
- ▲ Retail Properties
- ■ Industrial Properties

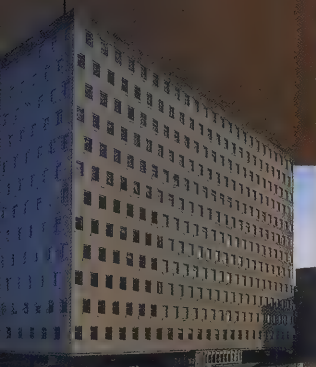
Place Désormeaux
Longueuil, Québec

66 Ronson Drive
Toronto, Ontario

Portfolio Summary

Category	Leasable Area
Total Office Properties	1,847,343 sq.ft.
Total Retail Properties	1,458,277 sq.ft.
Total Industrial Properties	2,539,140 sq.ft.
Total Portfolio	5,844,760 sq.ft.

Portfolio Summary



Fairmont Medical
Vancouver, British Columbia

Place Désormeaux
Longueuil, Québec

Office Properties

Province	City	Property	Location	Leasable Area (square feet)
British Columbia	Vancouver	U.K. Building	409 Granville Street	204,724
		Fairmont Medical	750 West Broadway	129,596
Alberta	Edmonton	Scotia Place	10060 Jasper Avenue	549,033
		Devonian	11160 Jasper Avenue	159,175
	Calgary	Fifth and Third	505 3rd Street S.W.	134,829
		Alberta Treasury	239 8th Avenue S.W.	41,559
		6020 Business Centre	6020 1A Street S.W.	40,335
		Gary Parkade	240 9th Avenue S.W.	0
Manitoba	Winnipeg	Border Place	1313 Border Street	102,572
		310 Broadway	310 Broadway Avenue	49,574
Ontario	Toronto	200 Yorkland	200 Yorkland Boulevard	143,019
		20-24 Lesmill	20-24 Lesmill Road	27,577
		285 Yorkland	285 Yorkland Boulevard	25,229
	Ottawa	Times Square	47 Clarence Street	111,713
Québec	Pointe Claire	Centre de la Cité Pointe Claire	1 Holiday Street	128,408
Total Office Properties				1,847,343

Retail Properties

British Columbia	Vancouver	Dueck Motors	86 Marine Drive S.E.	174,834
	Coquitlam	Burquitlam Plaza	526-562 Clark Road	82,975
	Victoria	Shelbourne Plaza	3601-3675 Shelbourne Street	56,878
Alberta	Calgary	Whitehall	225 8th Avenue S.W.	4,650
		207 8th Avenue	207 8th Avenue S.W.	2,044
		Centre 58	105 58th Avenue S.E.	39,480
	Edmonton	Cambrian	10114-18 111th Street	7,557
Ontario	Toronto	780-784 Yonge	780-784 Yonge Street	12,176
		760-762 Yonge	760-762 Yonge Street	2,950
		13 Bloor	13 Bloor Street West	3,708
		15 Bloor	15 Bloor Street West	6,472
		1875 Leslie	1875 Leslie Street	51,945
	Mississauga	Kingsbury Centre	1891 Rathburn Road East	69,891
	Kanata	Market Square	Kanata	41,353
	Aurora	Aurora Centre	Aurora	207,698
	Barrie	Cedar Pointe	4-75 Cedar Pointe Drive	337,467
	Belleville	Centrepoint	199 Bell Boulevard	123,196
Québec	Longueuil	Place Désormeaux	2877/85 Chemin Chambly	233,003
Total Retail Properties				1,458,277

Industrial Properties

Province	City	Property	Location	Leasable Area (square feet)
British Columbia	Vancouver	Boundary Park	3600-3630 1st Avenue E.	60,500
		Main Industrial	8417-8559 Main Street	118,422
		Columbia Industrial	250-86 Marine Drive S.W.	60,598
		Marine Industrial	100-28 Marine Drive S.E.	73,690
		Southvan	30-54 69th Avenue E.	70,348
	Burnaby	Scientific Atlanta	7725 Lougheed Highway	83,822
Alberta	Calgary	Cleveland	4006-36 4th Street S.E.	31,893
		Manchester Industrial	501 Cleveland Court S.E.	84,759
		Manhattan	451 42nd Avenue S.E.	26,400
	Edmonton	Window Tech	8705 63rd Avenue	31,171
		114th Avenue Multiple	16135-45 114th Avenue	38,220
		N.A.I.T.	11311 120th Street	69,807
		Sheffield I	15703/35 114th Avenue	113,773
		Plaza 103	6029-53 103rd Street	28,049
		99 Street	5405 99th Street	47,241
		Centre 51 North	9730-8 51st Avenue	31,443
		Centre 51 South	9729/51 51st Avenue	40,542
		Centre 51 West	9750-66 51st Avenue	37,396
		Sheffield II	15803-19 114th Avenue	48,216
Manitoba	Winnipeg	Carlton Place	100-6,110-4,547-55 King Edward Street	67,078
		1245 Border	1245 Border Street	71,140
		1435 St. James	1435 St. James Street	50,400
		1215 Border	1215 Border Street	18,360
		Westview	1391-1421 St. James Street	92,355
Ontario	Toronto	66 Ronson	66 Ronson Drive	31,700
		16 Lesmill	16 Lesmill Road	48,514
		135 Railside	135 Railside Road	44,787
		279 Yorkland	279 Yorkland Boulevard	17,810
		280 Yorkland	280 Yorkland Boulevard	32,040
	Mississauga	5040 Timberlea	5040 Timberlea Boulevard	179,226
		Timberlea North	5670-5700 Timberlea Boulevard	116,346
		6695 Pacific Circle	6695 Pacific Circle	70,742
	Cambridge	Pinebush	225 Pinebush Avenue	302,352
Québec	St. Laurent	Henri-Bourassa	8000 Henri-Bourassa	300,000
Total Industrial Properties				2,539,140
Total Portfolio				**5,844,760**

99th St. Multiple
Edmonton, Alberta

280 Yorkland Blvd.
Toronto, Ontario

Office Portfolio

Centre de la Cité
Pointe Claire, Québec

Our strong market presence and extensive infrastructure enable us to act quickly and intelligently to capitalize on opportunities.

6020 Business Centre
Calgary, Alberta

310 Broadway
Winnipeg, Manitoba

Demand for space continued to improve in 1998 and vacancies decreased accordingly.

Times Square
Ottawa, Ontario

Devonian Building
Edmonton, Alberta

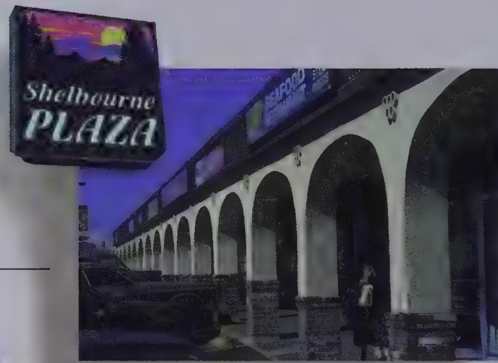
285 Yorkland Blvd.
Toronto, Ontario

Values remain below replacement cost, meaning that rents will continue to rise before any large-scale development takes place.

U.K. Building
Vancouver, British Columbia

200 Yorkland Blvd.
Toronto, Ontario

Retail Portfolio



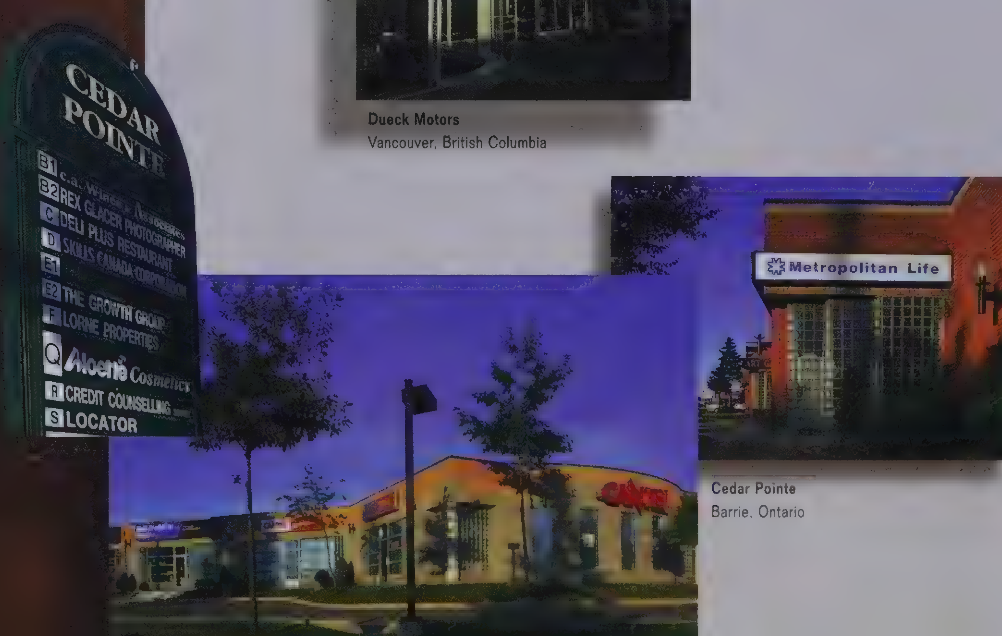
Shelbourne Plaza
Victoria, British Columbia

Market Square
Kanata, Ontario

Aurora Centre
Aurora, Ontario

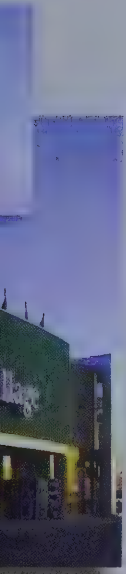
The retail market remains robust and the portfolio is very well positioned to take advantage of this positive trend.

Dueck Motors
Vancouver, British Columbia



Cedar Pointe
Barrie, Ontario

Increased consumer confidence pushed up retail sales and profits in 1998.



Place Désormeaux
Longueuil, Québec

The retail business is highly specialized. Our experts understand the underlying criteria for success and quickly eliminate opportunities that do not match up.

Burquitlam Plaza
Coquitlam,
British Columbia

Kingsbury Centre
Mississauga, Ontario

Industrial Portfolio

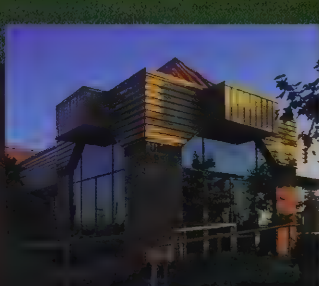
Centre 51 West
Edmonton, Alberta

Centre 51 South
Edmonton, Alberta

We expect that, in 1999, we will be able to identify further quality investments at attractive yields.

6695 Pacific Circle
Mississauga, Ontario

279 Yorkland Blvd.
Toronto, Ontario



Timberlea North Industrial
Mississauga, Ontario

Plaza 103
Edmonton, Alberta

Scientific Atlanta
Burnaby, British Columbia

99th Street Multiple
Edmonton, Alberta

Industrial design-build projects have been in high demand.

5040 Timberlea Blvd.
Mississauga, Ontario

135 Railside
Toronto, Ontario

8417-8559 Main Street
Vancouver, British Columbia

We are skilled at identifying opportunities to create value in the life cycle of a property through redevelopment, renovation or disposition.

Westview Place
Winnipeg, Manitoba

Management's Discussion & Analysis

Morguard REIT

The Trust is a real estate investment trust governed by the laws of the Province of Ontario and constituted pursuant to a Declaration of Trust. It owns a diversified portfolio of 67 properties with approximately 5.9 million square feet of office, industrial and retail space located in British Columbia, Alberta, Manitoba, Ontario and Québec.

The Trust began operations on October 14, 1997 with the issue of units and debentures and the purchase of 60 properties for $345 million. During 1998, the Trust successfully completed its first full year of operations and, in doing so, acquired seven properties and sold two properties.

Management's discussion of the financial results should be read in conjunction with the audited financial statements and their notes for the periods ended December 31, 1997 and 1998. When reviewing the financial discussion, the reader should keep in mind that the 1997 results include only 79 days of operation.

Results of Operations

For the year ended December 31, 1998, the Trust reported operating income of $38.9 million compared to $32.7 million forecast in the prospectus at the time of the public offering. This increase is primarily due to the acquisition of nine new properties since the Trust completed its initial public offering, as well as to decreased vacancies and increased rent in the portfolio over this period of time.

Operating income (000s)	For the year ended Dec. 31, 1998 Actual	Dec. 31, 1998 Forecast
Properties purchased October 14,1997	$ 33,015	$ 32,256
Properties sold during 1998	395	477
	33,410	32,733
Properties purchased in 1997	1,772	1,761
Properties purchased in 1998	3,703	3,584
Total operating income	$ 38,885	$ 38,078

At December 31, 1998, the Trust's properties were approximately 95 percent occupied. The Trust expects occupancy levels to remain near this level during 1999, however, rental revenues should continue to increase as leases are renewed at higher rental rates. During the next three years, 42.4 percent of the leases expire as follows:

(000s)	GLA	1999	2000	2001
Office	1,847	240	382	250
Retail	1,458	83	145	391
Industrial	2,539	365	326	310
Total	5,844	688	853	951
Percent of Total Portfolio		11.8%	14.6%	16.3%

Debenture Interest

Debenture interest for 1998 was $11.8 million compared to the forecast of $9.3 million. The increase resulted from the issue in April 1998 of $55 million principal amount of 6.625 percent redeemable senior unsecured debentures, due April 9, 2008. These funds were used to help finance the acquisitions completed during the year. Interest on all debentures is payable semi-annually in April and October.

Trust Expenses

Trust expenses in 1998 amounted to $3.1 million compared to the forecast of $2.0 million. Advisory fees were $2 million compared to $1.5 million in the forecast. The increase is primarily due to additional fees from the nine acquisitions made since the initial public offering. The advisory fee is calculated as 0.5 percent of gross book value (the book value of the assets plus accumulated depreciation and amortization calculated in accordance with generally accepted accounting principles) of the Trust up to $200 million of assets, and 0.35 percent on gross book value in excess of $200 million.

Included in advisory fee expense for 1998 is an incentive fee payable to the Advisor of $245,000. The incentive fee is calculated as 10 percent of the amount by which distributable income per unit exceeds the December 31, 1998 forecast distributable income per unit multiplied by the weighted average number of units outstanding in the year.

Instalment Receipt Expense/(Income)

During 1997, the Trust raised $252 million in equity by issuing instalment receipts. A $6 payment was received at the time of issue and a second $4 payment was due on October 14, 1998. At the time of issue, the Trust negotiated a $100 million loan facility with The Bank of Montreal secured by the instalment receipts. The proceeds were used to assist in financing the purchase of the original portfolio. The interest expense related to this loan for 1998 totalled $3.9 million with a weighted average interest rate of 5.01 percent.

Generally accepted accounting principles require that imputed interest income be calculated on the outstanding instalment receipt receivable. A discount rate of 4.05 percent was used to determine the interest income on the outstanding instalment receivable of $100.8 million. The imputed interest income for 1998 totalled $3.1 million.

Gain on Sale

The Trust sold two properties in 1998 for proceeds of $14.1 million resulting in a gain on sale of $1.9 million.

Distributions to Unitholders

The Trust distributes its net income after adjusting for depreciation, imputed interest and any reserve the trustees, in their discretion, deem reasonable. The adjusted net income is referred to as distributable income. The calculation of 1998 distributable income is as follows:

(000s)	
Net income	$ 22,306
Add: Depreciation expense	2,501
Less: Instalment receipt interest income	(3,074)
Distributable income	$ 21,733
Distributed income	18,137
Payout ratio	83.5%

The distributed income of $18.1 million or 72 cents per unit compares favourably to the forecast distribution of $16 million or 70 cents per unit. The distribution was paid quarterly as follows:

Record Date	Payment Date	Distribution per Unit	Distribution (000s)
March 31, 1998	April 15, 1998	16.5¢	$ 4,156
June 30, 1998	July 15, 1998	16.5¢	4,156
September 30, 1998	October 15, 1998	16.5¢	4,156
December 15, 1998	December 31, 1998	22.5¢	5,669
		72.0¢	$18,137

The maintenance of its properties is critical to the long-term success of the Trust. In order to fund these costs, the Trust has two options: use operating lines and repay these with proceeds raised from equity and debt markets; or, retain sufficient funds from operations. The Trust has elected in 1998 to withhold sufficient funds from operations as calculated below.

Cash flow from operations	$ 20,384
Leasing costs	(1,973)
Capital projects	(88)
Repair projects	(1,090)
Gain on sale	1,873
Adjusted funds from operations	$ 19,106
Distributions	18,137
Over/(Under)	969
Ratio	94.9%

Tax Summary

Because the Trust distributed an amount in excess of its income for tax purposes in 1998, the Trust had no liability for income tax under Part I of the Income Tax Act in 1998. The tax-deferred portion of the 1998 distribution is 73.96 percent. This portion of the distribution will reduce the adjusted cost base of the unitholders' units and be taxed as a capital gains when the units are sold.

Capital gains represent 10.20 percent of the distribution and will be taxed at the lower rate. Finally, 15.84 percent of the distribution is income from a trust and taxed at the unitholder's marginal tax rate. The tax-deferred portion of distributions will vary in any given year due to the amount and timing of asset acquisitions, dispositions and equity offerings.

ASSETS

Income producing properties

Income producing properties totalled $436.7 million at December 31, 1998, an increase of $69.3 million during the year. The Trust has a 100 percent undivided interest in each of its properties, although Scotia Place located in Edmonton is part of a larger complex. During 1998, the Trust made seven acquisitions (three industrial, one office and three retail properties) for approximately $84 million. As well, the Trust sold two properties during the year for $14.1 million.

The Trust's strategy is to own a diversified portfolio of office, industrial and retail assets located across Canada. The Trust believes that, by diversifying the portfolio, it is able to provide a higher rate of return at a lower level of risk.

Instalment receipts receivable

As at December 31, 1998, instalment receipts receivable was nil compared to the balance of $97.7 million as at December 31, 1997. During 1997, $252.9 million of equity (including the overallotment) was raised by issuing instalment receipts which required $6 per unit or $151.1 million to be paid on closing and a further $4 per unit or $100.8 million due on October 14 1998, the first anniversary of the date of issue. The instalment receipts receivable was collected in full.

LIABILITIES

Debentures payable

Debentures payable on December 31, 1998 totalled $195 million, an increase of $55 million during the year. Outstanding debentures are:

Description	Maturity Date	(000s) Principal Amount
6.625% Redeemable Unsecured Senior Debentures, Series 1998-1	April 9, 2008	$ 55,000
6.6% Redeemable Unsecured Senior Debentures, Series 1997-1	Oct. 9, 2007	112,000
7.0% Redeemable Unsecured Subordinated Debentures, Series 1997-2	Oct. 9, 2007	28,000
		$195,000

In 1998, the Trust issued $55 million principal amount of 6.625 percent of Redeemable Unsecured Senior Debentures, Series 1998-1 due April 9, 2008 for net proceeds of $54.4 million.

The Trust's Senior Debentures and Subordinated Debentures have been rated A (low) and BBB, respectively, by Dominion Bond Rating Service Limited and A (Low) and B++ (Low), respectively, by C.B.R.S. Inc.

The Trust Indenture, under which the debentures are issued, provides that the Trust shall not incur or assume additional indebtedness unless:

- The Trust's indebtedness to gross book value of its assets is less than 50 percent;
- Its secured indebtedness to gross book value is less than 10 percent; and
- Its consolidated earnings before income taxes, depreciation and amortization to its consolidated interest expense for the last four fiscal quarters is equal to or greater than 1.5:1.

On December 31, 1998, the interest coverage ratio was 3.03 (1997 - 3.15) and secured indebtedness was nil (1997- nil). The Trust's total indebtedness was 43 percent of gross book value, compared to December 31, 1997 of 37 percent.

UNITHOLDERS' EQUITY

Unitholders' equity was $239.3 million on December 31, 1998 compared to $235.1 million on December 31, 1997. During the year, the Trust recorded net income of $22.3 million and distributions of $18.1 million resulting in an increase in equity of $4.2 million during the year.

LIQUIDITY

On December 31, 1998, the Trust had $474,000 in cash and a $35 million credit facility to provide funds for working capital, capital improvements and future acquisitions. Under the terms of the Trust Indenture, this could be increased to 10 percent of gross book value or $45 million.

The Trust does not intend to distribute 100 percent of distributable income but will hold back funds for working capital and maintenance. In 1998, 16.5 percent of distributable income was withheld.

The Trust owns assets that range in type and size from small industrial properties to a twin tower Class "A" office building. This diversification enhances the liquidity of the portfolio since smaller assets can be easily sold.

Over the longer term, the Trust will need to access the capital markets to grow. The Trust intends to access the equity markets when conditions are acceptable and funds are required. The Trust cannot issue additional debentures without first raising equity as the maximum debt to gross book value cannot exceed 50 percent.

RISKS AND UNCERTAINTIES

The Trust is exposed to certain risks that can have significant impact on its operations. It is the responsibility of the Trustees and the Advisor to structure the affairs of the Trust in such a way to mitigate the impact of these risks.

Cash flow from the Properties

The most significant operating risk is the ability of the Trust to maintain its cash flow by ensuring the properties are fully leased. Diversification of the portfolio by geographic location, product type and tenant mix minimizes the Trust's risk to vacancies. As well, the Advisor has an office in or near each location where the Trust has investments to ensure good tenant relationships and to enable issues to be addressed on a timely basis.

Investment Guidelines and Operating Criteria

All organizations are subject to uncertainty that could impact profitability. To mitigate the exposure, the Trust has established guidelines to limit the maximum leverage allowed, the levels of floating rate debt and development exposure. As well, the Trust has negotiated appropriate insurance coverages and established comprehensive environmental programs.

Year 2000

Like all businesses that depend on automated information technology, the Trust has been actively involved in ensuring that its information systems and those of its suppliers and tenants, will make a smooth transition to the January 1, 2000 date change. The Trust has completed an inventory of its computer systems, evaluated the Year 2000 risk, introduced the necessary changes and is now testing to reduce the likelihood of business interruption. The Trust, for all critical applications, relies on third party suppliers of technology. Working with these suppliers, we have upgraded our system to be Year 2000 compliant.

The Trust expects to be Year 2000 compliant by mid 1999. The costs associated with testing for Year 2000 compliance are incurred by the Advisor and, as a result, the Trust should not incur any material expense. Based on its current assessment, the Trust believes that the Year 2000 will not have an impact on its results, operation or financial condition. However, there can be no assurance that this will be the case.

Management's Responsibility for Financial Reporting

Management of Morguard Real Estate Investment Trust is responsible for the preparation, integrity and fair presentation of the financial statements and all other information contained in the annual report. The accompanying financial statements have been prepared in accordance with generally accepted accounting principles, and are based on management's best estimates and judgements. Other financial information in the annual report is consistent with that in the financial statements.

The Trust maintains systems of internal control which are designed to provide reasonable assurance that accounting records are reliable and to safeguard the Trust's assets. Grant Thornton, Chartered Accountants, the independent auditor, is responsible for auditing the financial statements and giving an opinion thereon.

The Board of Trustees is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board carries out this responsibility through the Audit Committee. The Audit Committee meets with management and the independent auditors who have full access to the Audit Committee and Board of Trustees.

Antony K. Stephens
President and Chief Executive Officer

Bart S. Munn
Treasurer and Chief Financial Officer

Auditors' Report

We have audited the balance sheets of Morguard Real Estate Investment Trust as at December 31, 1998 and 1997 and the statements of income and unitholders' equity and cash flows for the year ended December 31, 1998 and the period from October 14, 1997 to December 31, 1997. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 1998 and 1997 and the results of its operations and cash flows for the periods then ended in accordance with generally accepted accounting principles.

Toronto, Canada
January 28, 1999

Grant Thornton

Grant Thornton
Chartered Accountants

Balance Sheets

(000s)	December 31 1998	December 31 1997
Assets		
Income producing properties (Note 3)	$ 436,727	$ 367,464
Other assets (Note 4)	4,756	2,710
Receivables	3,543	1,185
Loan receivable (Note 5)	1,333	-
Prepaids	777	244
Cash and cash equivalents	474	6,164
Instalment receipts receivable (Note 6)	-	97,686
	$ 447,610	$ 475,453
Liabilities		
Debentures payable (Note 7)	$ 195,000	$ 140,000
Payables and accruals	8,627	6,726
Deferred revenue	3,170	1,804
Security deposits	1,546	1,378
Loan payable (Note 8)	-	90,447
	208,343	240,355
Unitholders' equity (Note 9)	239,267	235,098
	$ 447,610	$ 475,453

Commitments (Note 12)
Uncertainty due to the Year 2000 Issue (Note 15)
See accompanying notes to the financial statements

On behalf of the Board of Trustees

The Honourable Barbara McDougall
Trustee

J. Rob Collins
Trustee

Statements of Income and Unitholders' Equity

(000s)	Year ended December 31 1998	October 14 to December 31 1997
Income from real estate assets		
Income from properties	$ 66,786	$ 11,568
Property operating expenses	25,581	4,375
Property management fees	2,320	424
	27,901	4,799
Operating income	38,885	6,769
Debenture interest	11,801	1,994
Depreciation	2,501	467
Amortization of leasing costs	304	15
Amortization of financing costs	220	41
	14,826	2,517
Operating income from real estate	24,059	4,252
Trust expenses		
Advisory fees	1,990	336
General and administrative	1,092	154
	3,082	490
Income before other items	20,977	3,762
Loan interest expense	3,874	865
Instalment receipt interest income (Note 6)	(3,074)	(826)
Interest and other income	(256)	(91)
	544	(52)
Income before gain on sale	20,433	3,814
Gain on sale of income producing properties	1,873	-
Net income	$ 22,306	$ 3,814
Basic net income per unit (Note 9)	$0.89	$0.16
Fully diluted net income per unit (Note 9)	$0.88	$0.16
Unitholders' equity, beginning of period	$235,098	$ -
Issue of units	-	251,900
Issue costs	-	(13,731)
Discount on instalment receipts receivable	-	(3,900)
Net income	22,306	3,814
Distributions to unitholders	(18,137)	(2,985)
Unitholders' equity, end of period	$239,267	$235,098

See accompanying notes to the financial statements.

Statements of Cash Flows

(000s)	Year ended December 31 1998	October 14 to December 31 1997
Cash derived from (applied to)		
Operating		
Net income	$ 22,306	$ 3,814
Items not affecting cash		
Gain on sale of income producing properties	(1,873)	-
Instalment receipt interest income (Note 6)	(3,074)	(826)
Depreciation	2,501	467
Amortization	524	56
Cash flow from operations	20,384	3,511
Leasing costs	(1,973)	(911)
Change in non-cash operating items	544	8,479
	18,955	11,079
Financing		
Issue of units (net)	-	238,169
Issue of debentures (net)	54,403	138,145
Instalment receipts receivable	100,760	(100,760)
Loan payable	(90,447)	90,447
Distributions to unitholders	(18,137)	(2,985)
	46,579	363,016
Investing		
Purchase of income producing properties	(84,026)	(367,931)
Sale of income producing properties	14,135	-
Loan receivable	(1,333)	-
	(71,224)	(367,931)
Change in cash during the period	(5,690)	6,164
Cash and cash equivalents, beginning of period	6,164	-
Cash and cash equivalents, end of period	$ 474	$ 6,164

See accompanying notes to the financial statements.

Notes to the Financial Statements

December 31, 1998

1. The Trust

Morguard Real Estate Investment Trust (the "Trust") is a closed-end real estate investment trust established on June 18, 1997 under the laws of the Province of Ontario. The Trust commenced active operations on October 14, 1997. As a closed-end real estate investment trust, the units of the Trust are traded on the Toronto Stock Exchange and there are no provisions for redemptions.

The Trust has entered into an advisory agreement with Morguard Investments Limited (the "Advisor") whereby the Advisor provides investment advice and certain administrative services to the Trust.

2. Summary of significant accounting policies

Basis of presentation

The Trust's financial statements are prepared in conformity with generally accepted accounting principles and its accounting treatment of income producing properties, accounting policies and standards of financial disclosure are substantially in accordance with the recommendations of the Canadian Institute of Public Real Estate Companies.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Income producing properties

Income producing properties are stated at the lower of cost less accumulated depreciation and net recoverable amount. Net recoverable amount of the real property investments is its estimated future net cash flow from use together with its residual value. Depreciation of the properties, excluding land, is recorded on the 5 percent sinking fund method to fully amortize the cost of buildings over 40 years. Acquisition costs, including any acquisition fees payable to the Advisor (Note 12), are capitalized as part of the cost of income producing properties.

Sale of income producing properties

A sale of income producing properties is recognized when all the material requirements of the sale agreement have been met, the risks of ownership have passed to the purchaser and an appropriate deposit has been received.

Other assets

Major leasing costs are deferred and amortized on a straight-line basis over the terms of the related leases. Financing costs are amortized on a straight-line basis over the terms of the debentures.

3. Income producing properties

(000s)	1998			1997
	Cost	Accumulated Depreciation	Net Book Value	Net Book Value
Land	$ 115,053	$ -	$ 115,053	$ 105,590
Buildings	324,626	2,952	321,674	261,874
	$ 439,679	$ 2,952	$ 436,727	$ 367,464

4. Other assets

(000s)	1998			1997
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Leasing costs	$ 2,871	$ 306	$ 2,565	$ 896
Financing costs	2,452	261	2,191	1,814
	$ 5,323	$ 567	$ 4,756	$ 2,710

5. Loan receivable

The loan receivable bears interest at 9 percent per annum and is repayable on March 25, 2001.

6. Instalment receipts receivable

Under the terms of the public offering of the units, 40 percent of the issue price of each unit totalling $100,760,000 was receivable on the first anniversary date of issue. This amount has been discounted for imputed interest at 4.05 percent for the year. Accrued interest income of $3,074,000 (1997 - $826,000) has been recognized in the period. The amount was received on October 14, 1998.

7. Debentures payable

(000s)	1998	1997
The debentures are redeemable and unsecured and interest is payable semi-annually on April 9 and October 9.		
6.6% senior debentures (mature October 9, 2007)	$ 112,000	$ 112,000
6.625% senior debentures (mature April 9, 2008)	55,000	-
7.0% subordinated debentures (mature October 9, 2007)	28,000	28,000
	$ 195,000	$ 140,000

8. Loan payable

The loan payable, secured by instalment receipts receivable, with interest at a weighted average rate of 5.01 percent per annum was repaid from their proceeds on October 14, 1998.

9. Units issued and outstanding

	1998	1997
The number of units issued and outstanding for the Trust are as follows:		
Initial public offering	22,900,000	22,900,000
Over-allotment option	2,290,000	2,290,000
Distribution reinvestment plan	104	-
	25,190,104	25,190,000

Options have been granted to independent trustees, officers of the Trust and senior officers of the Advisor to purchase a total of 110,000 units at $10 each exercisable over five years from October 14, 1997, and 385,000 units at $9.35 each exercisable over five years from March 18, 1998.

Net income per unit is calculated using the weighted average number of units issued and outstanding during the year; for basic 25,190,009 (1997 - 24,523,291), and for fully diluted 25,685,009 (1997 - 24,633,291).

10. Credit facility

The Trust has an operating line of credit of up to $35 million, all of which is unused at December 31, 1998. As security, the Trust has provided a general security agreement over all assets.

11. Income taxes

The Trust is taxed as a "Mutual Fund Trust" for income tax purposes. Pursuant to the Declaration of Trust, the trustees intend to distribute or designate all taxable income directly earned by the Trust to unitholders of the Trust and to deduct such distributions and designations for income tax purposes. Accordingly, there has been no provision for income taxes. The Trust intends to annually claim the maximum amount of deductions available in determining its income for tax purposes.

12. Commitments

The Trust has entered into various agreements for the purchase and development of properties. Should all conditions be met, expenditure over the next five years is estimated at $45 million. This amount will be financed through debt and/or equity.

Notes to the Financial Statements

The advisory agreement provides that the Trust pay to the Advisor the following:

An annual advisory fee equal to 0.50 percent of the gross book value of the first $200 million of the Trust and 0.35 percent of the gross book value of the Trust in excess of $200 million;

An acquisition fee of 1 percent of the total acquisition price on any purchase of real property by the Trust;

A disposition fee of 0.25 percent of the total sale price on any sale of real property by the Trust;

An incentive fee, commencing January 1, 1998, equal to 10 percent of the amount, if any, by which distributable income per unit in any year exceeds the forecast distributable income per unit for the year ended December 31, 1998 multiplied by the weighted average number of units outstanding in any year;

A development fee of up to 3 percent for development or redevelopment, refurbishment or capital project of real property owned by the Trust;

Property management fees averaging 3.5 percent of gross revenue from real property owned by the Trust;

Leasing fees, related to market rates, ranging from 2 percent to 6 percent of the total of new leases. Fees for the renewal of a lease are one-half of the fee for a new lease. Leasing fees include documentation fees.

During the year, the Trust paid the following fees to the Advisor: advisory fees $1,745,000 (1997 - $336,000); incentive fee $245,000 (1997 - $Nil); acquisition/disposition fees $855,000 (1997 -$169,000); property management fees $2,320,000 (1997 - $424,000); and leasing fees $1,088,000 (1997 - $113,000).

13. Financial instruments and risk management

Fair values

The fair value of the majority of the Trust's financial assets and liabilities, representing net working capital, approximate the carrying value at December 31, 1998 due to their short-term nature. In these circumstances, fair value is determined to be the market or exchange value of the assets and liabilities. The fair value of the loan receivable and the debentures payable approximate the carrying value.

Risk management

The Trust is exposed to financial risk that arises from the fluctuation in interest rates and in the credit quality of its tenants. The Trust manages these risks as follows:

Interest rate risk

Interest rate risk is minimized as debts are financed at fixed rates with maturities scheduled over future years. Total debt is restricted to 50 percent of the gross book value of the assets, and total floating rate debt is restricted to 10 percent of the gross book value of the assets.

Credit risk

Credit risk arises from the possibility that tenants may experience financial difficulty and be unable to fulfill their lease commitments. The Trust's credit risk is limited to the recorded amount of tenant receivables. Anticipated bad debt loss has been provided for in the allowance for doubtful accounts. The Trust mitigates this risk of credit loss by ensuring that its tenant mix is diversified and by limiting its exposure to any one tenant.

14. Segmented information

The Trust's operations cover three types of income producing properties located in five regions. The following presents financial information for these property types and regions.

(000s)	Year ended December 31, 1998		
	Total Revenue	Net Operating Income	Income Producing Properties
Property type			
Office	$ 34,145	$ 18,190	$ 180,748
Industrial	14,458	9,244	110,802
Retail	18,183	11,451	148,129
	$ 66,786	$ 38,885	$ 439,679
Geographic			
British Columbia	$ 16,898	$ 10,276	$ 121,256
Alberta	19,228	11,156	99,526
Manitoba	3,608	2,049	17,490
Ontario	20,801	12,375	163,293
Québec	6,251	3,029	38,114
	$ 66,786	$ 38,885	$ 439,679

Income producing properties are before accumulated depreciation.

(000s)	Period from October 14 to December 31, 1997		
	Total Revenue	Net Operating Income	Income Producing Properties
Property type			
Office	$ 6,077	$ 3,137	$ 167,522
Industrial	2,556	1,746	93,811
Retail	2,935	1,886	106,598
	$ 11,568	$ 6,769	$ 367,931
Geographic			
British Columbia	$ 3,557	$ 2,235	$ 126,532
Alberta	3,697	2,069	98,700
Manitoba	782	352	17,483
Ontario	2,997	1,941	95,973
Québec	535	172	29,243
	$ 11,568	$ 6,769	$ 367,931

Income producing properties are before accumulated depreciation.

15. Uncertainty due to the Year 2000 Issue

The Year 2000 issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using the year 2000 date is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure, which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 issue affecting the Trust, including those related to the efforts of tenants, suppliers, or other third parties, will be fully resolved.

16. Comparative figures

Certain comparative figures for 1997 have been reclassified to conform with the current year's presentation.

Trustees & Officers

Investor Information

Head Office	Morguard Real Estate Investment Trust One University Avenue Suite 1500 Toronto, Ontario M5J 2V5 Tel. (416) 862-3800 Fax (416) 862-3799
Listing	Toronto Stock Exchange
Symbol	MRT.UN
Eligibility	RRSP, RRIF, DPSP
Auditors	Grant Thornton, Chartered Accountants
Principal Bankers	The Bank of Montreal
Corporate Counsel	Blake, Cassels & Graydon
Transfer Agent	The Trust Company of the Bank of Montreal 1 First Canadian Place Suite 5104 Toronto, Ontario M5X 1A1 Tel. (800) 332-0095 Fax (514) 877-9676
Investor Relations Contact	Bart Munn Treasurer and Chief Financial Officer Tel. (416) 862-3770 Fax (416) 862-3799 Email: bmunn@morguard.com
Website	www.morguard.com

Morguard
Real Estate Investment Trust